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No. 87-984

In The
Supreme Court of the United States
October Term, 1987

SHELL OIL COMPANY,
Appellant,
v.
THE IOWA DEPARTMENT OF REVENUE,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF IOWA

BRIEF OF AMICI CURIAE IN SUPPORT OF THE APPELLEE BY THE STATE OF NEW JERSEY AND THE STATES OF ARIZONA, ARKANSAS, COLORADO, IDAHO, MARYLAND, MINNESOTA, MISSOURI, MONTANA, NEW YORK, NORTH DAKOTA, OREGON AND SOUTH CAROLINA

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INTEREST OF AMICI CURIAE

Two concerns prompt this brief on behalf of *amici curiae*, the States of Arizona, Arkansas, Colorado, Idaho, Maryland, Minnesota, Missouri, Montana, New Jersey, New York, North Dakota, Oregon and South Carolina. All impose either a corporate franchise tax measured by net income or a corporate net income tax, and all use formulary apportionment to determine the portion of entire net income derived from sources within the taxing state.* Acceptance of Shell's position would seriously erode the unitary business principle, which underlies and justifies formulary apportionment. The keystone of Shell's argument is that the net income of a unitary business can be sourced to specific sites, *e.g.*, the Outer Continental Shelf ("OCS"). The idea that the net income of a unitary business can be sourced to particular geographic locales was rejected by this Court in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 *U.S.* 425 (1980), and in *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 *U.S.* 207 (1980), and, having reappeared chameleon fashion here, should be rejected again.**

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* *Amici* other than Arizona, Idaho, Minnesota, New York and North Dakota determine apportioned net income using the net income and apportionment factors of the single corporate taxpayer doing business within the taxing state. Arizona, Idaho, Minnesota, New York and North Dakota use combined reporting which measures apportioned net income by taking into account the income and apportionment factors of a unitary group of corporations. *See Container Corp. v. Franchise Tax Bd.*, 463 *U.S.* 159 (1983). This distinction is not material here because the income in question is includable in the income base under both measurements.

** New Jersey has a particular interest in the case because it is the respondent in *Amerada Hess Corp. v. Director, Divi-*

(Continued on following page)

The other concern prompting *amici* to file this brief is that all of them, like Iowa, include in their respective net income bases income which Shell claims is earned on the OCS. All *amici* are thus concerned with the precise legal issue presented, the potential revenue loss, and the difficult questions of proof and computation inherent in Shell's position.

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ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT DOES NOT PREEMPT THE STATE OF IOWA FROM IMPOSING ITS CORPORATE NET INCOME TAX ON THE APPORTIONED NET INCOME OF A UNITARY BUSINESS, INCLUDING INCOME ALLEGEDLY EARNED ON THE OUTER CONTINENTAL SHELF.

This is a preemption case. Thus the primary question is whether Congress, in enacting the Outer Continental Shelf Lands Act, (43 *U.S.C.* sections 1331 *et seq.* ("OCSLA")), intended to preclude Iowa from imposing its corporate net income tax on an apportioned share of Shell's net income when there has been no exclusion of income allegedly derived from the OCS. *See Shaw v. Delta Air Lines, Inc.*, 463 *U.S.* 85, 95 (1983); *Fidelity Federal*

(Continued from previous page)

sion of Taxation, No. 87-453 and *Texaco Inc. and Tenneco Oil Co. v. Director, Division of Taxation*, No. 87-464, probable jurisdiction noted 56 *U.S.L.W.* 3781 (May 16, 1988), which, like this case, involve the computation of the net income base of a unitary business. In joining in this brief, the other *amici* do not necessarily subscribe to New Jersey's position in Nos. 87-453 and 87-464.

Sav. & Loan Ass'n v. De La Cuesta, 458 *U.S.* 141, 152 (1982). In a review of a preemption challenge, state legislation is presumed valid; preemption is disfavored and is to be found only in the clearest cases of conflict. *Chicago & North Western Transportation Co. v. Kalo Brick & Tile Co.*, 450 *U.S.* 311, 317 (1981); *Maryland v. Louisiana*, 451 *U.S.* 725, 746-47 (1981). This presumption in favor of state legislation is particularly strong where a State is exercising a traditional function of its sovereignty, *e.g.*, taxation. *Metropolitan Life Ins. Co. v. Massachusetts*, 471 *U.S.* 724, 740 (1985); *Jones v. Rath Packing Co.*, 430 *U.S.* 519, 525 (1977).

Congressional intent to displace state law can be either express (*see e.g. Aloha Air Lines, Inc. v. Director of Taxation*, 464 *U.S.* 7 (1983); *Exxon Corp. v. Hunt*, 475 *U.S.* 355 (1986)) or implied. *Metropolitan Life Ins. Co. v. Massachusetts, supra* at 738. Implied preemption can be inferred from the pervasiveness of federal legislation which leaves no room for state intrusion, by the predominance of the federal interest in a particular field, by the objective of federal legislation, or the inconsistency of state legislation with a federal objective. *Rice v. Santa Fe Elevator Corp.*, 331 *U.S.* 218, 230 (1947); *Maryland v. Louisiana, supra*, at 746-47.

Since Shell asserts that the plain language of OCSLA prohibits imposition of the Iowa tax, *i.e.* that this is a case of express preemption, the starting point for the preemption analysis is the language of the federal statute. *See Exxon Corp. v. Hunt, supra* at 362. The language of OCSLA does not support Shell's argument.

Shell points to two provisions—section 1333(a)(2)(A), which provides in part that "State taxation laws shall

not apply to the outer Continental Shelf" and section 1333(a)(3), which provides in part that OCSLA "shall never be interpreted as a basis" for a State to claim "any interest in or jurisdiction . . . over the seabed and subsoil of the outer Continental Shelf . . . or the revenues therefrom." Even when this language is considered in a vacuum without reference to its context or legislative history, it does not have the meaning Shell advances.* Iowa is neither applying its corporate income tax to the OCS nor laying claim to an "interest in . . . revenues" from the OCS. Shell's argument to the contrary (*cf.* Shell b26) reflects a basic misunderstanding of what OCSLA intended and of the operation of the Iowa income tax. Iowa is not, and could not under the Due Process Clause, extend its income tax law to the OCS because the OCS is plainly not within the geographical boundaries and thus the political jurisdiction of Iowa. Iowa is confined to

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* Shell attempts to set the stage for its argument by reviewing a multitude of unrelated federal statutes containing various state tax preclusions (Shell b18). One need not quarrel with Shell's statement that Congress has the power to limit state taxation to nevertheless conclude that none of the cited statutes, with their varying preemption language, suggests the proper construction of OCSLA. To take 31 *U.S.C.* sec. 3124(a) as an example, it is clear that (1) Congress intended in section 3124 to create a tax exemption for stocks and obligations of the United States, (2) Congress specified the precise scope of the exemption, extending it to "each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax," and (3) having been specific in creating the exemption, Congress was explicit in validating two types of state taxation-nondiscriminatory franchise taxes, and estate or inheritance taxes. Section 1333(a) of OCSLA does not state that it is creating a tax exemption but rather that state taxation laws shall not apply to the OCS, and, being directed at state tax laws, not subjects exempt from state taxes, neither details particular types of preempted state taxes nor validates certain others.

taxing the in-state attributes of a unitary business. Those in-state values are determined by applying an apportionment factor to the net income of a unitary business. Assuming for the sake of argument that it could be demonstrated with certainty that Shell's net income included net income earned on the OCS,* the effect of the Iowa apportionment formula is to eliminate such income from the base. The Iowa apportionment factor is the ratio of Iowa sales to total sales, and in most other States the factor is the ratio of in-state sales, wages, and property to total sales, wages, and property. Included in the denominator of the sales fraction are those sales made by Shell on the OCS. Since there are no OCS sales in the numerator of the sales fraction nor any demonstrable OCS value in the numerator,** the effect of including those sales in the denominator is to remove OCS sales from the tax base or more precisely to remove a corresponding portion of net income from the tax base. Far from applying its tax law to the OCS, by means of its apportionment formula Iowa has eliminated any such extraterritorial extension of its income tax.***

Nor is Iowa asserting an interest in "revenues" from the OCS. Again, consistent with the Due Process Clause, Iowa could not, at least on an unapportioned basis, tax

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* As discussed below, it cannot be demonstrated what, if any, portion of Shell's net income was earned on the OCS.

** Shell has conceded that there is no way of determining "with any degree of certainty" whether its Iowa sales included crude oil having its ultimate source on the OCS (J.A.19).

*** The inclusion of OCS sales in the denominator of the apportionment factor is plainly not an extension of Iowa's taxing power to the Shelf. *See Maxwell v. Bugbee*, 250 *U.S.* 525, 539 (1919).

revenues from sales of natural gas and oil made on the OCS because the OCS is not within the territorial jurisdiction of Iowa. But Iowa is not taxing revenues; it is taxing net income apportioned to Iowa. The stumbling block of separate accounting and the rationale for the unitary business principle is that in the case of a unitary business it is impossible to determine the precise geographical sources of a company's net income. *Mobil Oil Corp. v. Commissioner of Taxes, supra* at 438. Since a company's net income derives "from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" *Ibid; and see Exxon Corp. v. Wisconsin Dept. of Revenue, supra* at 226, (rejecting Exxon's argument that income allegedly earned outside Wisconsin from the production of crude oil and natural gas should be deducted from the Wisconsin net income base).* Shell's attempt to isolate net income attributable to the OCS (J.A. 36 to 43) is to no avail because "the profit figures relied on by [Shell] are based on precisely the sort of formal geographic accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." *Container Corp. v. Franchise Tax Board,* 463 *U.S.* 159, 181 (1983). To take a single example, the expenses listed at J.A. 40 for exploration, land expense, research, and head office are prorated by Shell to the OCS. There is no assurance that such proration takes into account the true transfers of value between Shell's two operating segments—its Products Organization and its E & P Organization. These difficulties in isolating net income actually atributable to the OCS exist whether revenue is generated by a sale on the OCS or by a sale elsewhere. In either case it is impossible to determine what, if any, portion of OCS revenue or value ends up in net income. The contributions to net income from refining, manufacturing, and selling in the continental United States may far exceed the contribution to net income from sales or value on the OCS. *See Moorman Manufacturing Co. v. Bair,* 437 *U.S.* 267, 276 (1978).

* In *Exxon,* as here, there were two types of purported "situs" income—income attributable to the wellhead value of crude oil transferred downstream from Exxon's Exploration and Production Department to its Refining Department and income attributable to third party sales at the wellhead. 447 *U.S.* at 217. The Court did not reach the issue of wellhead sales because Wisconsin took the position that under its statute the income from such sales was excludable. 447 *U.S.* at 226 and n.10.

Shell argues (Shell b21) that there is no difference in "economic substance" between a single state tax on 100% of Shell's apportioned OCS income and state taxes levied directly on OCS production. To the contrary, if as Shell hypothesizes, it did business only in Iowa and on the OCS, the economic sources of Shell's net income would be entirely within Iowa except for its crude oil production on the Shelf. Under those circumstances, absent a showing of an egregiously excessive tax burden, Iowa could properly tax 100% of Shell's net income because it would be imposing its net income tax on the Iowa incidents of a unitary business. *See Moorman Manufacturing Co. v. Bair, supra.* That would not be the case, assuming again that Shell did business only in Iowa and on the OCS, were Iowa to impose its net income tax on a separate accounting basis on the entire value of Shell's crude oil production on the Shelf. The tax would not be related to the economic sources in Iowa of Shell's income but rather to Shell's

economic activities on the Shelf. Thus, in economic terms, the two impositions would be quite different, both in concept and amount.

When the language Shell points to is considered in its statutory context, as indeed it must be (*Richards v. United States*, 369 *U.S.* 1, 11 (1962)), Shell's argument collapses altogether. The language as to non-applicability of state taxation laws is the last sentence of section 1333(a)(2)(A). The preceding sentences of that section declare the civil and criminal law of *each adjacent* State to be the law of the United States for the portion of the OCS which would be within such State if its boundaries were extended seaward. This declaration capsulizes a significant congressional compromise between senators, including Senator Long, who advocated that the laws of the adjacent States should govern the administration of the OCS (*see Rodrigue v. Aetna Casualty & Surety Co.*, 395 *U.S.* 352, 358-59 (1969)), and those who maintained that federal maritime or admiralty law should apply (*Id.* at 361-65). The compromise set forth in section 1333(a)(2)(A) is that federal law applies to the OCS, but the law of the adjacent States is adopted as federal law. Behind the decision to use state law as federal law were the competing concerns that workers on OCS platforms were closely tied to the adjacent States but that state law and state political jurisdiction could not or should not be extended to those structures. *Id.* at 363-64.

The final sentence in section 1333(a)(2)(A) that "State taxation laws shall not apply to the outer Continental Shelf," viewed in context, is a natural sequel to the ideas expressed in the first part of the section. The incorporation of adjacent state law as federal law raised the

question of the applicability of the taxation laws of the adjacent States, and, making explicit the views of the Justice Department that state law and political jurisdiction could not and should not be extended to the OCS (*Id.* at 364), Congress included the quoted language. Thus, viewed in context, the obvious meaning of the sentence "State taxation laws shall not apply to the outer Continental Shelf" is to exclude the tax laws of both the adjacent and inland States from those state laws adopted as surrogate federal law.

Viewed in context, the language in section 1333(a)(3) (the other provision on which Shell relies) that OCSLA "shall never be interpreted as a basis" for a State to claim "any interest in or jurisdiction . . . over the seabed and subsoil of the outer Continental Shelf . . . or the revenues therefrom," is equally contrary to Shell's position. In *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 *U.S.* 473 (1981), this Court held that despite OCSLA's declaring the OCS to be an area of exclusive federal jurisdiction, state courts are not deprived of concurrent jurisdiction in those cases where state law has been declared surrogate federal law by section 1333(a)(2)(A). Relying, as does Shell, on section 1333(a)(3), the petitioner in *Gulf* argued that state court jurisdiction over a personal injury case would contravene the mandate that OCSLA "shall never be interpreted as a basis for claiming *any . . . jurisdiction* on behalf of *any state* for *any purpose* over the . . . outer Continental Shelf. . . ." (emphasis added). This Court replied:

> This argument again confuses the political jurisdiction of a State with its judicial jurisdiction. Section 1333(a)(3) speaks to the geographic boundaries of

> state sovereignty, because Congress primarily was concerned in enacting OCSLA to assure federal control over the Shelf and its resources. [453 *U.S.* at 482].

Gulf thus stands for the general proposition that depite the comprehensive prohibition of state jurisdiction over the OCS in section 1333(a)(3) certain kinds of non-political state jurisdiction remain unaffected. The thrust of section 1333(a)(3) is simply to set "the geographical boundaries of state sovereignty." State action which does not extend state boundaries into the OCS is not foreclosed. The additional phrase in section 1333(a)(3) that no State may claim "any interest in . . . the revenues" from the OCS is similarly directed at the territorial limitations on state sovereignty. As made clear in the Senate Report, the purpose of section 1333(a)(3) is to establish that the adoption of state law does not permit a State to participate "in the administration of or revenues from the areas *outside of State boundaries.*" *S. Rep. No.* 411, 83d Cong., 1st Sess. (1953), at 23 (hereinafter "Senate Report," emphasis added). Iowa's imposition of its corporate net income tax on the portion of Shell's net income derived from Iowa sources does not extend Iowa's boundaries or its political jurisdiction into the OCS. (If it were otherwise, no State could, consistent with the Due Process and Commerce Clause, impose its corporate net income tax on the apportioned entire net income of a unitary business.)

Gulf stands as well for the proposition that if a subject is not specifically mentioned in section 1333(a)(3) it is not beyond state jurisdiction.

> The language of [section 1333(a)(3)] refers to 'any interest in or jurisdiction over' real property, minerals and revenues, *not over causes of action.* . . . We do not think the legislative history of OCSLA can be read to rebut the presumption of concurrent state-court jurisdiction, given *Congress' silence on the subject in the statute itself.* [453 *U.S.* at 482-3 emphasis added].

Similarly here, OCSLA's silence regarding the imposition of an apportioned net income tax on net income derived from the Shelf should not rebut the presumption against preemption of state law.

OCSLA's legislative history, which Shell refers to at length (Shell b28 to 41), offers no more support to Shell than does the statute as enacted. The legislative history contains no direct reference to the adjustment Shell urges. Moreover, with the one exception discussed below, the numerous references in the legislative history to state taxation refer to the exercise of taxing jurisdiction by States adjacent to the OCS and to forms of taxation other than the corporate income tax. The single exception is the contention of Senator Long, an opponent of the legislation, that adjacent States would have costs as a result of the development of the OCS but no sources of revenue directly related to that development.. In enumerating the revenue sources which OCSLA foreclosed to Louisiana and the other adjacent States, Senator Long, in his Minority Report, included "the State's severance tax, property tax, [and] tax on corporate profits." *Senate Report* at 67. This single statement appears to be the only reference in the entire legislative history of OCSLA to corporate net income taxes. As such, it is no basis for in-

ferring the intent of Congress. As this Court recently stated in determining the effect of a single Senator's statement concerning the scope of the tax exemption found in section 5(e) of the National Housing Act of 1937:

> The relevant passage comes in the middle of a long speech, and no similar expression is to be found in any other legislative debate or document. This short isolated comment simply cannot overcome the understood meaning of section 5(e) and the presumption against implied tax exemptions. [*United States v. Wells Fargo Bank*, 56 *U.S.L.W.* 4265, 4267 (1988)].

Similarly here, Senator Long's isolated comment referring to Louisiana's tax on corporate profits cannot overcome the settled doctrine that the imposition of an apportioned net income tax does not extend a State's taxing jurisdiction beyond its borders.

Moreover, it is far from clear that Senator Long was thinking in terms of OCSLA's foreclosing the imposition of Louisiana's net income tax on an apportioned share of an integrated oil company's net income (*cf.* Shell b32). As made clear in *Texas Company v. Cooper*, 236 *La.* 380, 107 *So.*2d 676 (1958), while Louisiana had a corporate net income tax in the early 1950's which used formulary apportionment, the tax collector had the right to require separate accounting in cases where the apportionment method produced an unfair result:

> When the collector finds that use of the apportionment method by a taxpayer produces a manifestly unfair result and that the separate accounting method would more equitably determine the amount of net income derived from sources in Louisiana, he may require that the separate accounting method be used in such case. [236 *La.* at 390]

A regulation made clear that separate accounting could be required of oil companies engaged in the production of crude oil in Louisiana. *See* 236 *La.* at 409. In the *Texas Company* case, the Louisiana Supreme Court upheld the tax collector's determination that the oil company had to use separate accounting because formulary apportionment produced a manifestly unfair result. The Texas Company, although an integrated oil company, engaged only in the production, sale, and transportation of crude oil in Louisiana and had no refinery there. Separate accounting was appropriate, according to the court, because the production of crude oil in Louisiana was a discrete and easily quantifiable step. 236 *La.* at 399. In light of its statutory authority, its regulation, and the *Texas Company* case, had OCSLA permitted Louisiana to extend its taxation laws to the OCS, it is quite likely that Louisiana would have required separate accounting for production on the Shelf. Given Senator Long's views that Louisiana's severance and property taxes should have been applicable to the OCS (*Senate Report* at 67), it is entirely plausible that in referring to the State's tax on corporate profits, the Senator had in mind the application of separate accounting to production on the OCS. That, of course, is not what Iowa has done in taxing Shell.

Finally, the imposition of Iowa's apportioned net income tax with respect to Shell's activities in Iowa does not thwart the federal policies fostered by OCSLA, whether the original 1953 version or the 1978 amendments. Shell's suggestion to the contrary notwithstanding (Shell b35), "The legislative record suggests that maximization of economic returns was not the driving force behind the legislation." (Brief for the United States as *amicus curiae*

in *Shell Oil Co. v. Florida,* No. 86-1593). Rather, the federal policies sought to be accomplished by OCSLA were the establishment of "exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and the development of its vast mineral resources." *Senate Report* at 2, quoted in *Gulf Offshore Co. v. Mobil Oil Corp., supra* at 479, n.7. Iowa's imposition of its corporate net income tax on an apportioned share of Shell's net income, some of which may derive from the OCS does not in any way frustrate the exercise of federal jurisdiction and control over the OCS nor the development of the Shelf's resources. Iowa's tax in no way extends into the OCS nor reaches OCS development *per se.* The burden of the tax is simply too remote from the OCS to thwart OCSLA's policies.

In summary, neither OCSLA itself, nor its legislative history, nor the policies it promotes suggests that Congress intended to preempt the imposition of Iowa's apportioned net income tax with respect to Shell's activities in Iowa. Iowa is not extending its tax laws to the OCS nor is it claiming an interest in OCS revenues. Rather, it is subjecting to tax the Iowa incidents of Shell's unitary business. The tax base is net income apportioned to Iowa, and whether that net income base contains income earned on the OCS cannot be determined on this record. Even if that fact could be determined, Iowa's tax would still not violate OCSLA because it would remain a tax on the Iowa portion of Shell's net income, and there would still be no extraterritorial extension of Iowa's tax laws into the OCS.

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CONCLUSION

For the reasons stated above, the judgment of the Supreme Court of Iowa should be affirmed.

Respectfully submitted,

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